
RHODE ISLAND LOTTERY

MANAGEMENT COMMENTS

JUNE 30, 1999 AUDIT

Ernest A. Almonte, CPA, CFE
Auditor General

State of Rhode Island and Providence Plantations
General Assembly

Office of the Auditor General



ERNEST A. ALMONTE, CPA, CFE
Auditor General

State of Rhode Island and Providence Plantations

GENERAL ASSEMBLY

Office of the Auditor General

1145 Main Street
Pawtucket, Rhode Island 02860-4807

OFFICE
(401) 222-2435
FAX
(401) 222-2111

December 2, 1999

Joint Committee on Legislative Services, General Assembly
State of Rhode Island and Providence Plantations:

Members of the Rhode Island Lottery Commission:

We audited the financial statements of the Rhode Island Lottery (the "Lottery") for the year ended June 30, 1999 and have issued our report thereon dated September 9, 1999. In accordance with *Government Auditing Standards*, we have also issued a report dated September 9, 1999 on our consideration of the Lottery's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations and contracts.

Our report on the Lottery's compliance and internal control over financial reporting indicated a matter that we consider a reportable condition. Our report did not indicate any material instances of noncompliance. We did however note certain additional matters involving compliance, internal controls, and other operational matters that are presented for your consideration. These comments and recommendations are intended to enhance compliance with laws, regulations and contracts, improve internal control, or result in other operational efficiencies.

This report is intended for the information of the Joint Committee on Legislative Services, the Rhode Island Lottery Commission and Lottery management, and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,

Ernest A. Almonte, CPA, CFE
Auditor General

**RHODE ISLAND LOTTERY
MANAGEMENT LETTER
JUNE 30, 1999 AUDIT**

TABLE OF CONTENTS

| | <u>Page</u> |
|---|--------------------|
| <u>FINDINGS AND RECOMMENDATIONS</u> | 1 |
| INFORMATION SYSTEMS SECURITY..... | 1 |
| PRIZE WITHHOLDING FOR CHILD SUPPORT OBLIGATIONS | 1 |
| PRIZE PAYOUT PERCENTAGES | 2 |
| MONITORING..... | 3 |
| INSTANT TICKET VALIDATION CONTROLS | 3 |
| INSTANT TICKET ACTIVATION | 4 |
| PRIZE IMPREST ACCOUNT..... | 4 |
| FINANCIAL DATA..... | 6 |
| PURCHASING PROCEDURES - ADVERTISING..... | 6 |

FINDINGS AND RECOMMENDATIONS

INFORMATION SYSTEMS SECURITY

We noted a reportable condition in our *Independent Auditor's Report on Compliance and on Internal Control over Financial Reporting* issued as a result of our audit of the Lottery's financial statements for the year ended June 30, 1999. We found that logical access security to the computer systems used to operate the Lottery's games should be improved. Adequate controls over access to the Lottery's computer systems is essential due to the extent of control and processing delegated to its on-line and video lottery games contractor and because of the need to ensure the integrity of games operated by the Lottery.

The Lottery should develop and implement a formal comprehensive information systems security plan in conjunction with its on-line and video lottery games contractor. This plan would, at a minimum, (1) identify and fully utilize all designed security functions of the Lottery's gaming systems, (2) strengthen other system security aspects to ensure that adequate security measures are in place and operational, (3) delegate certain system security functions to the Lottery for appropriate segregation of duties and (4) implement procedures for continual monitoring of compliance with the overall information system security plan.

The Lottery is now in the process of engaging a consultant to assist in the development of the information system security plan.

RECOMMENDATION

1. Continue to take all necessary steps to result in the timely development of a comprehensive information security plan for the Lottery's gaming systems.

Auditee Views

The Lottery concurs with this recommendation and has issued a Request for Proposal for the development of an information systems security plan.

PRIZE WITHHOLDING FOR CHILD SUPPORT OBLIGATIONS

RI General Law Section 42-61-7.1 requires that outstanding child support obligations (greater than \$500) be deducted from Lottery prizes in excess of \$600. Such amounts are then remitted by the Lottery to Rhode Island Family Court. Information is periodically provided by Rhode Island Child Support Services (RICSS) which identifies individuals with outstanding child support obligations. For all prizes validated at Lottery headquarters, the Lottery's prize payment system compares the winner's

name and social security number with the data provided by RICSS and the appropriate withholding is made.

For video lottery games, the video lottery facilities are responsible for validation and payment of video prize awards. No procedure is in place, however, to withhold child support obligations from video lottery prizes paid at its video facilities. The Lottery should direct the video lottery facilities to withhold child support from prizes when required.

RECOMMENDATION

2. Implement procedures to allow for withholding of child support for video lottery prizes.

Auditee Views

The Lottery believes there are various issues which make the withholding of child support obligations from video lottery prize awards problematic. However, it will continue to explore ways to meet the objective of the law.

PRIZE PAYOUT PERCENTAGES

Section 42-61-15 of the Rhode Island General Laws (General Laws) states that “the amount of prize awards to holders of winning lottery tickets shall be determined by the commission, but shall not be less than forty-five percent (45%) nor more than fifty-five percent (55%) of the total revenue accruing from the sale of lottery tickets.” The General Laws also state that “for the lottery game commonly known as “Keno”, the amount of prize awards to holders of winning Keno tickets shall be determined by the commission, but shall not be less than forty-five percent (45%) nor more than sixty-five percent (65%) of the total revenue accruing from the sale of Keno tickets.”

The Lottery increased the prize structure for Keno on November 5, 1995. From November 5, 1995 through June 30, 1999, Keno’s prize payout has been 65.51% of total game revenue over this period. As reported in prior audits, this percentage has exceeded the 65% stipulated in the General Laws and has resulted in excess prize awards of \$887,580 based on total sales for this period.

RECOMMENDATION

3. Reevaluate the designed payout percentages for Keno to ensure compliance with the General Laws.

Auditee Views

The Lottery believes that when Keno prize recoveries of \$893,772 for the period November 5, 1995 to June 30, 1999 are included in the calculation it is in compliance with the law. An amendment to the General Law was submitted for consideration in the 1999 session of the General Assembly to change the payout from 65% to 68% but was not enacted. The Lottery will resubmit the legislation for consideration this year.

MONITORING

Due to the fact that a significant portion of Lottery operations are performed by others (i.e., on-line games contractor, central communications provider, and video lottery facilities), it is important that the Lottery have the resources to evaluate and monitor critical controls to ensure the integrity of lottery games and safeguard amounts due the Lottery.

As noted in prior audits, we believe the Lottery should improve its monitoring of all lottery operations. In response to our prior recommendations, the Lottery has developed a monitoring plan specific to video lottery operations and has improved its enforcement of the VLT procedures manual at the video lottery facilities.

However, during our audit, we noted weaknesses relating to financial monitoring and the monitoring of access to the Lottery's gaming systems. For instance, one video lottery facility had recently not been transferring cash to the Lottery on Mondays although required to do so in accordance with revised deposit procedures. Timely monitoring of deposit lag time for the video lottery facilities is an example of the comprehensive monitoring procedures that should be routinely performed. The issue discussed previously relating to information systems security is a further example of monitoring procedures that ensure that controls are in place and operating effectively over all Lottery operations.

RECOMMENDATION

4. Continue to develop and implement comprehensive monitoring procedures focusing on key financial and operating controls for Lottery activities conducted by others.

Auditee Views

The Lottery has corrected the specific instance cited regarding video lottery deposit procedures. The Lottery will continue to improve its monitoring to ensure the integrity of Lottery games.

INSTANT TICKET VALIDATION CONTROLS

The instant ticket validation system has a control which only allows validation of an instant ticket if the ticket has been recorded as “active” within the system. However, if a ticket presented for validation is within the retailer’s inventory but is listed as inactive or “received status”, the system will automatically activate the book and allow the ticket to be validated. By the system automatically activating the book of tickets, no warning or prompt is given to the retailer to warn them that the ticket is presently inactive. If an attempt was made to validate an “inactive” ticket at another retailer, the system would prevent validation. This control is in place to prevent payment of prizes for stolen tickets.

System controls should be enhanced by eliminating the automatic activation of a book of tickets and prompting the retailer in all instances that the ticket being presented for validation is from the “inactive” inventory. In the event that the retailer simply neglected to activate the book, they can quickly do so with little inconvenience to the customer.

RECOMMENDATION

5. Request that the system provider either eliminate the automatic activation feature or prompt the retailer in all instances where a ticket from the “inactive inventory” is presented for validation.

Auditee Views

A change was made by the Lottery’s on-line games contractor, effective October 14, 1999, to prompt retailers when a book of instant tickets has been auto-activated.

INSTANT TICKET ACTIVATION

During fiscal year 1999, the Lottery increased the maximum number of days that a book of instant tickets can remain “active” before the related revenue is recognized from 45 days to 180 days. Under the Lottery’s current instant ticket procedures, revenue from the sale of instant tickets is recognized when any of the following three criteria is met; (1) when the book has been listed in active status for 180 days; (2) when 85% of the number of low-tier prizes in the book are validated; or (3) the retailer has manually settled the ticket book. Under these procedures, a retailer could sell partial ticket books and delay the time period in which they would be required to pay for a book until 180 days.

The Lottery could improve controls over instant ticket revenue recognition by requesting that the on-line gaming system contractor enhance the system to automatically settle the first ticket book for a particular game when the retailer activates a second book for the same game. This enhancement would prevent retailers from delaying the recognition of ticket sales and ultimately the payment of amounts due to the Lottery while not penalizing retailers that legitimately need longer time periods to sell instant tickets.

RECOMMENDATION

6. Request that the system provider enhance the system to automatically settle the first ticket book for a particular game when the retailer activates a second for the same game.

Auditee Views

The Lottery's on-line games contractor made an enhancement to the system, effective October 18, 1999, to settle the first ticket book for a particular game when the retailer activates a second book for the same game.

PRIZE IMPREST ACCOUNT

The Lottery currently maintains a prize imprest checking account to issue prize awards (mostly high tier prizes) at Lottery headquarters. Each day, the Lottery must submit an invoice voucher to replenish the prize account for prize payments issued on the previous day of operations. During our audit, we noted an instance where the prize account was not replenished in a timely manner resulting in a significantly depleted prize fund.

The Lottery should explore the feasibility of establishing a zero balance account (ZBA) with the General Treasurer for purposes of making prize payments. A ZBA account is automatically reimbursed daily by the Treasurer for the amount of checks presented on the account for payment. A ZBA account would offer the following benefits for the Lottery;

- Cash for prize awards would remain in the Lottery's operating account until prize checks are presented for payment at the bank. This would enable these funds to be invested by the General Treasurer rather than remaining in a non-interest bearing checking account.
- No daily processing would be required by the Lottery or the State Controller to transfer cash to cover prize checks presented for payment.

A ZBA account may provide a more efficient method of managing the Lottery's prize fund, while giving the Lottery the opportunity to invest cash for prizes until prize checks are presented for payment.

RECOMMENDATION

7. Explore the feasibility of converting the Lottery's prize imprest cash account to a zero balance account.

Auditee Views

The Lottery converted its prize imprest bank account to a zero balance account effective November 1, 1999.

FINANCIAL DATA

The Lottery currently records most financial activity relating to gaming activities with the use of monthly standard journal entries. The Lottery prepares these standard journal entries monthly by summarizing daily activity into spreadsheets manually. By manually summarizing gaming data, the Lottery increases the probability that transposition errors and data entry errors will occur and not be detected by the Lottery in a timely manner. Also, the current process of summarizing daily gaming system information is manually intensive and time consuming.

Standard journal entry preparation could be made more efficient if the on-line gaming system could summarize monthly instant ticket and on-line gaming activity. The Lottery should request that the gaming system provider develop reports that summarize gaming activity into monthly intervals. Monthly reports would improve the preparation of standard journal entries by reducing the risk of errors associated with the current process.

RECOMMENDATION

8. Request reports summarizing monthly on-line and instant ticket data from the gaming system provider

Auditee Views

The Lottery concurs with this recommendation and is working with its on-line games contractor to develop a report which details validations by day and game.

PURCHASING PROCEDURES - ADVERTISING

The Lottery routinely engages vendors to develop and produce advertising for the Lottery's games. During our current audit, we noted procurement for the production of two television commercials in the amount of \$19,050. We found no documentation of the process followed in procuring these services although we were informed that proposals are routinely solicited from various agencies. While a sealed bid process is usually not appropriate or applicable for this type of procurement, the Lottery should, at a minimum, document its solicitation of proposals from various agencies. Further, the Lottery's purchasing policies and procedures should be amended (in compliance with General Law 37-2) to specifically address advertising since this is a recurring type of procurement for the Lottery.

RECOMMENDATIONS

9. Document solicitation of proposals for advertising.

10. Amend the Lottery's purchasing policies and procedures to specifically address procurement of the development and production of advertising.

Auditee Views

The Lottery concurs with these recommendations. The Lottery noted that this vendor was chosen because it was the only Rhode Island vendor that utilizes film rather than video resulting in a higher quality commercial.